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ANNUAL REPORT

Fiscal year 1988-1989

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Montana Lottery Commission

Spence Hegstad,
Chairman, Dillon

Pat DeVries,
Polson

Jim Moore,
Bozeman

Becky Erickson,
Glasgow

Bill Ware,
Helena

THE MONTANA LOTTERY
AFTER ONLY TWO YEARS

• Total Sales	$37.2 Million
• Total Prizes Paid	$16.8 Million
• Total Retailer Commissions	$2.1 Million
• Total Transferred To Office of Public Instruction	$11.2 Million
• Total Retailers	860

Figures include six days of sales in June 1987

Lottery Director

Chuck Brooke

MONTANA LOTTERY

FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 1989

MONTANA LOTTERY

FINANCIAL STATEMENTS

FISCAL YEAR ENDED JUNE 30, 1989

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APPOINTIVE OFFICIALS

Charles A. Brooke, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

		TERM EXPIRES
Spence Hegstad, Chairman	Dillon	January 1, 1990
Pat DeVries	Polson	January 1, 1991
Jim Moore	Bozeman	January 1, 1990
Bill Ware	Helena	January 1, 1993
Becky Erickson	Glasgow	January 1, 1993

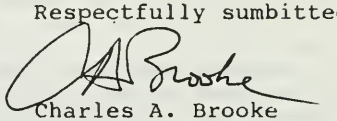
LOTTERY LIAISON COMMITTEE

Senator Hubert Abrams	Wibaux
Senator Ethel Harding	Polson
Representative Linda Nelson	Medicine Lake
Representative Norman Wallin	Bozeman

RECOMMENDED CHANGES

The Lottery Law specifically requests that recommendations for change be included in this report. In the Director's report at the end of last fiscal year, seven specific recommendations were made. With the passage of House Bill 207 during the 1989 legislative session, all seven of the recommended changes were made. For the next fiscal year, the Montana Lottery will continue to focus on the successful implemenation and application of the changes. Therefore, no additional recommendations are offered at this time.

Respectfully sumbitted,



Charles A. Brooke
Director

CAB/ac

Junkermier · Clark
Campanella · Stevens · P.C.

Certified Public Accountants

Ward F. Junkermier, CPA
George L. Campanella, CPA
Stone E. Paulson, Jr., CPA
Rick A. Frost, CPA
Robert E. Nebel, CPA
Joseph F. Shevlin, CPA
Ronald A. Taylor, CPA
Kent A. Borglum, CPA
Terry L. Alborn, CPA
William J. Eidel, CPA
Walter J. Kero, CPA

Commissioners
Montana State Lottery
Helena, Montana

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying balance sheets of Montana State Lottery as of June 30, 1989, and 1988, and the related statements of revenue, expense, changes in retained earnings, and changes in financial position for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery as of June 30, 1989, and 1988, and the results of its operations, and changes in financial position for the years then ended in conformity with generally accepted accounting principles.

Junkermier, Clark, Campanella, Stevens, PC

Helena, Montana
September 26, 1989

Montana Club Bldg. • P.O. Box 1164 • Helena, MT 59624 • (406)-442-6901
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MONTANA STATE LOTTERY
BALANCE SHEETS

ASSETS

	June 30 1989	June 30 1988
CURRENT ASSETS		
Cash	$ 786,702	$3,788,451
Accounts receivable	664,497	222,300
Inventory	133,974	199,217
Prepaid expenses	1,338	22,098
Employee advances	5,000	5,050
	1,591,511	4,237,116
FIXED ASSETS		
Computer, furniture and equipment	737,014	734,764
Computer software	840,400	840,400
	1,577,414	1,575,164
Less: accumulated depreciation and amortization	(577,866)	(294,792)
	999,548	1,280,372
OTHER ASSETS		
Advertising license fee, net of accumulated amortization of $11,209 in 1989 and $-0- in 1988	88,791	-
	$2,679,850	$5,517,488

LIABILITIES AND FUND EQUITY

CURRENT LIABILITIES		
Long-term debt due within one year	$ 189,204	$ 282,208
Accounts payable and accruals	85,663	50,652
Due to State Superintendent of Public Instruction	306,410	1,232,477
Due to other state agencies	65,422	88,936
Accrued compensated absences	74,789	74,705
Claimed prizes payable	-	2,350,180
Unclaimed estimated prize reserve	1,505,143	1,025,235
Allowance for ticket returns	287,964	291,420
	2,514,595	5,395,813
LONG-TERM DEBT, net of current portion	165,284	261,110
FUND EQUITY (DEFICIT)		
Unreserved retained earnings (deficit)	(29)	(139,435)
	$2,679,850	$5,517,488

See the accompanying independent auditor's report and the notes to financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF REVENUE, EXPENSE AND CHANGES IN RETAINED EARNINGS

	Years ended June 30	
	1989	1988
OPERATING REVENUE		
Ticket sales	$11,644,061	$21,787,581
License fees	3,600	5,900
	11,647,661	21,793,481
OPERATING EXPENSE		
Prizes	5,300,097	9,807,415
Retailer commissions	669,313	1,210,074
Cost of tickets sold	630,843	800,141
Personal services	905,375	977,415
Contracted services	272,668	186,586
Advertising	231,536	573,503
Amortization	179,289	168,080
Depreciation	114,994	107,912
Supplies and materials	71,589	55,119
Rent and utilities	93,969	101,598
Communications	64,193	88,863
Travel	35,877	58,078
Repairs and maintenance	76,313	72,198
Management service fees	71,446	74,800
Other	15,148	10,835
	8,732,650	14,292,617
NET OPERATING INCOME BEFORE NONOPERATING EXPENSE AND OPERATING TRANSFERS	2,915,011	7,500,864
NONOPERATING REVENUE (EXPENSE)		
Interest expense	(913)	(18,022)
Operating transfers to State Superintendent of Public Instruction	(2,774,692)	(8,375,894)
NET INCOME (LOSS)	139,406	(893,052)
Reserved (unreserved) retained earnings (deficit) at beginning of year	(139,435)	1,235,684
Less prior period adjustments	-	(482,067)
RESERVED (UNRESERVED) RETAINED EARNINGS (DEFICIT) AT END OF YEAR	$ (29)	$ (139,435)

See the accompanying independent auditor's report and the notes to financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF CHANGES IN FINANCIAL POSITION - CASH BASIS

	Years ended June 30	
	1989	1988
SOURCES OF CASH		
Provided from operations		
Net operating income	$ 2,915,011	$ 7,500,864
Add (deduct) non-cash items:		
Amortization and depreciation	294,283	275,992
Decrease (increase) in:		
Accounts receivable	(442,197)	3,252,527
Inventory	65,243	202,394
Prepaid expense	20,760	(13,527)
Employee advances	50	(4,770)
Increase (decrease) in:		
Accounts payable	35,011	(952,215)
Due to State Superintendent of Public Instruction	(926,067)	1,232,477
Due to other state agencies	(23,514)	(2,928)
Compensated absences	84	43,389
Claimed prizes payable	(2,350,180)	2,350,180
Unclaimed estimated prize reserve	479,908	391,987
Allowance for ticket returns	(3,456)	(731,017)
Cash provided from operations before nonoperating expenses and operating transfers	64,936	13,545,353
Interest expense	(913)	(18,022)
Operating transfers out	(2,774,692)	(8,375,894)
Cash provided (used) by operations	(2,710,669)	5,151,437
USES OF CASH		
Acquisition of fixed assets	2,250	55,295
Acquisition of advertising license fee	100,000	-
Payment of long-term debt	188,830	273,737
Payment of loan to general fund	-	1,230,000
	291,080	1,559,032
Increase (Decrease) in cash	(3,001,749)	3,592,405
Cash at beginning of year	3,788,451	196,046
CASH AT END OF YEAR	$ 786,702	$ 3,788,451

See the accompanying independent auditor's report and the notes to financial statements.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 1989 and 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization:

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. Section 23-5-1001, Montana Code Annotated (MCA) establishes the provision of the code under which the Montana State Lottery operates. The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer regional lottery games and prepare financial reports.

Disposition of revenue is a minimum of 45% for prizes, a minimum of 5% for commissions to sales agent, payment of operating expenses and the remaining revenue to the State Superintendent of Public Instruction for equalization aid to the retirement funds.

The State of Montana provides certain services to the Lottery covering: central payroll, accounting, self-insurance, communication, motor pool and various other services. The costs charged to the Lottery for these services, approximately $1,140,000 are reflected in the expenses.

Reporting Entity:

The Lottery, a division within the Montana Department of Commerce, is considered a component unit of the oversight unit known as the State of Montana. There are no component units to be included within the Lottery as a reporting agency.

Basis of Accounting:

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition:

Sales of lottery instant tickets are made to licensed retailers, who in turn sell the tickets to the public. Retailers receive a minimum of 5% commission. Revenue is recognized when the tickets are delivered to the retailers. Tickets not sold by the retailer may be returned to the Lottery for credit. Sales are reduced for estimated ticket returns.

Prizes:

Prize expense is recognized based on the predetermined prize structure for each game. Free tickets are recorded as a reduction in revenue and not as prize expense.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventory:
Inventories consist of tickets and supplies. Ticket inventory includes lottery tickets stored in the warehouse and with marketing representatives. The tickets are carried at cost using the specific identification method. Tickets are charged to cost of sales when sold and unsold tickets are charged to cost of sales upon the end or cancellation of a game.

Supply inventory is carried at cost and expensed as used.

Fixed Assets:
Fixed assets are recorded at cost and depreciation or amortization is computed using the straight-line basis over the following estimated useful lives:

Computer	6 years
Software	5 years
Vehicles	4 years
Furniture and equipment	6 - 10 years

Advertising License Fee:
Advertising license fee is recorded at cost and amortization is computed using the straight-line basis over a 3-year estimated useful life.

Accounts Receivable:
Accounts receivable represent amounts due the Lottery for purchased tickets. These amounts are electronically transferred within 28 to 34 days of ticket receipt. Bad debts are nominal and no allowance for doubtful accounts has been established.

Compensated Absences:
State employees earn vacation leave ranging from 15 to 24 days per year depending on the individuals years of service. Vacation leave may be accumulated to not exceed 2 times the maximum annual leave. Sick leave is earned at 12 days a year with no maximum accumulation. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave.

2. CASH

Cash is as follows:

	June 30 1989	June 30 1988
Cash on deposit with State Treasurer	$ 776,552	$3,787,895
Cash in revolving checking account	10,000	-
Petty cash	150	556
	$ 786,702	$3,788,451

Cash on deposit with State Treasurer is part of pooled cash in the state treasury which is not separately identifiable as to specific types of securities. See the statewide audit for the level of risk associated with the cash and cash equivalents. Interest earned on these funds are General Fund earnings and not reflected in the Lottery's financial records.

3. LONG-TERM DEBTS

	June 30 1989	June 30 1988
Long-term debts consist of the following:		
Installment purchase of Instant Lottery System software payable in monthly payments of $11,672 including no interest through March 1990 and $23,344 including no interest through February, 1991.	$ 350,167	$ 536,922
Lease purchase of copier payable in monthly payments of $249 including interest at 16.7% through February, 1991	4,321	6,396
	354,488	543,318
Less portion due within one year	189,204	282,208
Long-term portion	$ 165,284	$ 261,110

The following is a summary of maturities due on long-term debt as of June 30, 1989:

Fiscal Years ended June 30	
1990	$ 189,204
1991	165,284
	$ 354,488

4. OBLIGATION TO TRANSFER FUNDS TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

The remaining portion of gross revenue not used for payment of prizes, commissions, and operating expenses is transferred quarterly from the Lottery to the State Superintendent of Public Instruction for distribution as equalization aid to retirement funds. At June 30, 1989 and 1988, $306,410 and $1,232,477, respectively, were payable to the State Superintendent of Public Instruction. Operating transfers of $2,774,692 and $8,375,894 were reported during the fiscal years ended June 30, 1989, and 1988, respectively.

5. LEASE COMMITMENTS

The Lottery has a lease for office and warehouse space in Helena, Montana. Lease expense included in the operating expenses is $81,600 and $81,600 for the fiscal years ended June 30, 1989 and 1988, respectively. Minimum future lease payments, under all non-cancellable leases, are as follows:

Fiscal Years Ended June 30	
1990	$ 81,600
1991	81,600
1992	54,400
	$ 217,600

6. EMPLOYEE RETIREMENT SYSTEM

The Lottery and its employees make contributions to the Montana Public Employees Retirement System (PERS) defined benefit plan. The Lottery is required to contribute for full time employees at the rate of 6.417% of annual compensation under state statute. Employees are required to contribute 6% of annual compensation. Part-time employees have an option to belong to the retirement plan, depending upon hours worked. The Montana Public Employees' Retirement System does not segregate financial information for each participating entity.

The total number of Lottery employees covered during the year ended June 30, 1989 and 1988 was 31 and 34, respectively. The total payroll for the employees was $730,400 in 1989, and $725,464 in 1988. The Lottery's contributions were $46,870 and $46,553 for the years ended June 30, 1989, and 1988. Benefit eligibility is age 60 with at least 5 years of service; age 65 regardless of service; or 30 years of service regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least 5 years of service. Monthly retirement benefits are determined by taking 1/60 times the number of years of service times the final average salary. Members' rights become vested after 5 years of service.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the system's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers. The Lottery is unable to determine the actuarial present value of credited projected benefits and net assets available for benefits since the information is available only on a total State basis, not agency basis.

The pension benefit obligation at June 30, 1988, for the State system as a whole was $945,736,000. The system's net assets available for benefits at cost on June 30, 1988, were $692,753,000, leaving an overall unfunded pension benefit obligation of $252,983,000. The Lottery's 1989 contribution represented approximately .17% of total June 30, 1988, contributions required of all participating entities. The Lottery is not responsible for any state system unfunded liability.

Ten-year historical trend information showing the State system's progress in accumulating sufficient assets to pay benefits when due is presented in the system's June 30, 1988 annual financial report. Only the first year of the required 3-year trend information is available.

7. DEFERRED COMPENSATION PLAN

The Lottery's employees are eligible to participate in the State of Montana's deferred compensation plan. The State of Montana administers the plan by contractual arrangement with Nationwide Insurance.

8. SUBSEQUENT EVENTS

The Lottery plans to begin on-line lottery games during the next fiscal year. Lottery staff has awarded, but not signed, a contract for computer equipment and professional services related to the start of these games.

9. CHANGE IN ACCOUNTING ESTIMATES AND PRIOR PERIOD ADJUSTMENT

The Lottery adjusted its accounting estimate for recognizing revenue to include estimates of returned tickets as a reduction in revenue in the year the ticket was sold. In its first period of operation ending June 30, 1987, the returned tickets were not taken into consideration in reporting revenue due to the absence of a historical perspective regarding the future returned tickets. The effect of the change is recorded as a reduction in retained earnings in the amount of $483,079 in order that the June 30, 1988 financial statements can be presented in accordance with generally accepted accounting principles. This reduction in retained earnings is offset by $1,012 for additional small corrections of errors.

10. CONTRACTUAL ARRANGEMENTS

Tickets - The Lottery has signed agreements to purchase instant game tickets from Scientific Games, Inc., through March 8, 1990. This contract may be terminated by the Lottery with proper notification to Scientific Games, Inc.

Computer Hardware and Software Maintenance - The Lottery has signed an agreement for computer hardware and software maintenance from Stratus Computer, Inc. for $4,433 per month.

11. GAMES

Currently, the Lottery games are instant ticket games. These games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize. Players also have another chance to win by submitting five non-winning tickets for the Big Spin drawing.

12. PRIZE CONTINGENCIES

Certain prizes awarded are payable to the winners in annual installments of 17 to 20 years, with the first payment being made

12. PRIZE CONTINGENCIES (Continued)

by the Lottery at the time of the Big Spin. The Lottery has entered into agreements with an insurance company under which purchased annuities will provide payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance company will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments if the insurance company was to default on their payments.

At June 30, 1989, the Lottery had purchased annuity contracts to fund future installment payments aggregating $4,493,824. The annuities purchased in the fiscal year ended June 30, 1989, cost $2,350,180 and funded $4,746,912 of future installments.

OTHER

INFORMATION

MONTANA LOTTERY
SUMMARY OF FINANCIAL DISTRIBUTION
FISCAL YEAR ENDED JUNE 30, 1989

COMMISSIONS - Section 23-5-1016(10), MCA provides retailers a 5% commission on tickets or chances sold. The commission on tickets sold to the retailer gives the retailer $15 per book of 300 tickets. The 5% commission of $669,313 for the year ended June 30, 1989, is based on gross lottery ticket sales of $13,051,009 plus approximately 335,000 net estimated ticket returns.

OPERATING EXPENSES - The Lottery, according to Section 23-5-1007(9), MCA, must prepare quarterly and annual reports on all aspects of the operation of the state lottery, including gross revenue and operating expenses. Gross revenue includes net lottery ticket revenue and license fees. While retailer commissions, by law, are not considered an operating expense, interest expense is considered an operating expense for this purpose. Total operating expenses for the year ended June 30, 1989, using the accrual basis of accounting, is as follows:

	Year ended June 30, 1989
Net lottery ticket revenue	$11,644,061
License and permits	3,600
Total Gross Revenue	$11,647,661
Operating expenses	2,763,240
Interest expense	913
Total Operating Expense	$ 2,764,153

The above operating expenses of $2,764,153 include $913 in interest expense, $630,843 for ticket purchases, $188,830 for installment purchase payments and $2,250 in capital equipment expenses. The ticket purchases, installment purchase payments, and capital equipment expenses were reclassified, using the accrual basis of accounting, to reflect the ticket inventory, the decrease in installment purchase payable, and capitalization of assets.

For budgetary purposes, nonbudgeted expenses, netting to $81,773 for amortization, depreciation, personal service expenses related to compensated absences, and cost of goods sold are not reflected in the operating expenses of $2,680,579. $12,000 in audit fees and $1,544 for printing services is included in the $2,680,579 operating expenses above. These expenses are not included in the financial statements because these fees relate to services to be provided in fiscal year 1989-1990.

STATE SUPERINTENDENT OF PUBLIC INSTRUCTION TRANSFER - The funds transferred to the State Superintendent of Public Instruction, by law, are not based on a percentage of revenue. The distribution is based on a definition of net revenue. Net revenue is that part of all gross revenue not used for the payment of prizes, commissions, and operating expenses. Net revenue for the fiscal year ended June 30, 1989, is detailed below:

	Year Ended June 30, 1989
Income before Operating Transfers	$2,914,098
Retained Earnings, Beginning of Period	(139,435)
Net Revenue for Fiscal Year 1988-1989	$2,774,663
Net Revenue Transferred to State Superintendent of Public Instruction	$2,774,692
Retained Earnings at End of Period	$(29)

PRIZES - Section 23-5-1027(1a), MCA, states "A minimum of 45% of the money paid for tickets or chances must be paid out as prize money..."

Prize expense is recorded based on the predetermined prize structure percentage for each game. For the fiscal year ended June 30, 1989, the prize expense of $5,300,097 is 45.52% of the net Lottery revenue of $11,644,061.

When recording the prize expense, a corresponding liability for high-tier and Big Spin prizes is also recorded. The relationship between prize expense, prizes paid and the change within prize liability is illustrated below:

July 1 through June 30, 1989		Percent of Net Lottery Ticket Revenue
Prizes paid	$4,858,110	41.72
Purchase of annuities	2,350,180	20.19
Instabucks	(37,876)	(.33)
Increase (decrease) in prize liability	(1,870,317)	(16.06)
Prize expense	$5,300,097	45.52

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